2015

NOTCH PARTNERS

USING EXECUTIVE ANGLES AND RELATIONSHIPS TO GAIN THE EDGE IN PRIVATE EQUITY

As private equity firms continue to search for an edge inside and outside the general auction environment, the strategic insights and input of experienced industry leaders increasingly have become a competitive differentiator to winning the deal. Notch Partners' Using Executive Angles and Relationships to Gain the Edge in Private Equity discusses strategies and best practices for PE investors to leverage their executive relationships and drive value.

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC

USING EXECUTIVE ANGLES AND RELATIONSHIPS TO GAIN AN EDGE IN PRIVATE EQUITY

The environment for private equity deals is becoming increasingly competitive. According to the 2014 Bain Global Private Equity Report, in 2013, undeployed capital ("dry powder") exceeded $1 trillion. Widely available debt and equity capital drove deal values up; in the wake of cautious buyers, sellers sought to recapitalize their businesses or go public, causing overall deal count to decrease by 22% in 2013. While credit availability will always be a driver for deal activity, private equity firms are becoming more strategic and proactive in developing a competitive edge. Efforts to gain an upper hand include: sector and market analysis and focus, early target identification and cultivation and executive relationship-building. The primary difference in these initiatives versus more reactive behavior in an auction-driven culture, is that this work is preemptive and longer-term in nature. Hence, the challenge becomes about direction and focus. One critical area where PE firms can differentiate is developing and cultivating industry executive relationships for longer term value. A robust network is enormously impactful for PE firms. Executives provide industry perspectives, company insights and sometimes valuable connections to other CEOs and business owners; with guidance, they can originate compelling private equity deal theses based on expertise, vision and industry contacts.

In 2014, the private equity deal environment presents a number of challenges. Dry powder continues to reach new heights causing buyer frenzy in highly competitive auction processes. Over the past ten years, executive relationships have emerged as a differentiator for PE firms searching for proprietary ideas and angles. Today, expert networks and digital intermediaries such as LinkedIn have in many ways commoditized the identification and access to individuals. However, in any given deal situation, many firms are now competing for few executive insights. In light of this development, the savviest investors are focused on developing strategic longer-term relationships that are mutually interesting and productive.

"The surest path to growth for PE firms today is by first strengthening and deepening the capabilities that make them distinctive and building a repeatable model for sourcing deals, applying fresh insights before and after acquisitions and cultivating superior returns over and over again".

Bain Global Private Equity Report 2014

As private equity firms internalize the strategic importance of executive relationships, the demand for executive attention has increased, much like the ongoing effort to cultivate investment banking relationships. Today, there are several vehicles that enable and promote access to executives, including expert networks, PE-focused search firms, executive networking groups and consulting firms. In addition, PE firms and executives are accessing each other organically through common industry contacts, investment bankers or simply by reaching out

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC

directly. The plethora of access points has created a proliferation of connections and interactions.

To manage and retain their growing network of executives, PE firms have tried to "institutionalize" a multi-faceted approach. Subscribing to expert networks or connecting via LinkedIn, (a professional networking tool), has become a routine approach. In many ways, LinkedIn has disintermediated those who exist to make connections. Within PE firms, existing management structures have established defined roles for executives: Operating Partner, Industry Advisor, Senior Advisor, and Executives-in-Residence. Some PE firms have designated business development professionals who manage "deal and executive flow." With such infrastructure being established, now it is time to focus on defining, tracking and measuring productivity in those relationships. Whereas access and interaction were the goals a decade ago, today the focus is on creating long-term strategic value with relationships that are mutually interesting, beneficial and lead to quantifiable results. PE firms must integrate CEOs into their deal equation, as consultants, advisors and when appropriate, leveraging their experience throughout the value chain: from deal diligence and execution through portfolio ownership.

Most PE firms have figured out how to leverage executives as subject matter experts for deal diligence. Utilizing expert networks and LinkedIn as well as their own rolodexes, PE investors routinely identify and contact executives who have specific knowledge on targets and industries. Whether it is a former CEO of the target or a major competitor, supplier or customer, with access to millions of names across various databases, obtaining a relevant opinion no longer presents a challenge. *It's no longer a differentiator either.* As the market for subject matter expertise has become commoditized, the demand for a more unique angle or truly proprietary insights is becoming more competitive.

A pioneer in the world of PE-Executive relationships, Notch Partners has focused on creating meaningful interactions and productive partnerships for PE firms and industry-leading CEOs since 2002. With over 17,000 executives in the Notch network and thousands of executive introductions made to PE firms, from a front row seat, Notch has helped to shape the paradigm. Notch's service model is singularly focused on helping PE firms develop a strategic mindset and a long-term approach to executives. Based on hundreds of data points and a myriad of anecdotal evidence, Notch has observed the following trends:

- CEOs and PE firms are establishing connections informally and organically, through their peers, colleagues and other networks. *Identification and access no longer presents a challenge.*

- CEOs are being contacted by multiple PE firms to opine on the same deal. While some understand how auctions work, many are confused by the ambiguity and stop-go dynamic of the competitive bidding process.

- In an effort to get "first dibs" and "lock up" an executive, PE firms are reaching out earlier during auction processes, and speaking with multiple executives to create optionality and to obtain insights as early and quickly as possible. In many cases, PE firms are contacting executives well in advance of auction processes in

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC

anticipation of potential competition from other firms.

The frenzy that has surrounded good companies in play, has now spilled over to the world of executives. In most auctions, however, a sell-side banker is retained to control and maintain professionalism in the process. In the absence of formal intermediation and defined rules of engagement, the murky and free-form "executive exchange" poses greater risk for confusion and miscommunication. The ensuing disconnects present opportunities for savvy PE firms to differentiate.

With a frenetic deal environment as the backdrop to an increasingly competitive market for executive attention, PE firms must now differentiate themselves in order to continue to tap into valuable CEO-level knowledge and expertise. Discrete opinions during one or two phone calls – even if from leading experts – are becoming commoditized; in the absence of commitment from any one PE firm, executives have limited motivation to spend time chatting about a deal with multiple PE firms or on the flip side, provide their advice exclusively. Rather, many executives are growing tired of providing expertise and what they view as "free consulting" derived from decades of experience in the trenches, sometimes with little follow-up and no material gain. Many semi-retired industry veterans are confused when asked to evaluate an offering memorandum, provide their insights and analysis on a phone call and sometimes jump on a plane to attend a management meeting, for minimal and sometimes no compensation. The lure of PE networking and the promise of a potential role "down the road" becomes less thrilling after much time and effort with a range of PE firms dissolves quickly into air. Sometimes highly interactive dialogues can drop with no explanation, and the executive wonders if, how and where they may have fallen short - until they are called weeks or months later to opine on the next deal. Perhaps the worst consequence of this dynamic: executive circles are growing disillusioned about private equity, whether based on their own or their peers' experiences. Some of the most accomplished and seasoned CEOs have given up on private equity entirely.

How can a PE firm differentiate itself among CEOs, and turn their executive relationships into a competitive advantage?

Show professional interest and courtesy: Treat an executive with the same level of professionalism and respect shown to the CEO of a target or a sell-side banker. Whether it's a general networking meeting or a diligence call, inquiring as to the executive's current status and their interests creates rapport and demonstrates longer-term engagement. Typically, semi-retired executives are not seeking employment and therefore have no self-serving agenda for the conversation. While most PE firms are very good at introducing themselves, their investment approach and objectives, not all demonstrate interest in the executive's interests. After initial pleasantries, PE-Executive conversations typically progress quickly to discussion about industries, companies and potential deals. If the executive has proprietary insights or contacts, PE investors want to be front and center on the executive's radar screen for future contact. If this is the case, PE firms should invest the time and energy to engage in the conversation and follow-up. After the meeting, email a thank-you; take the executive to lunch when paths cross and schedules align; share ideas. Keep the conversation going, so when a

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC

proprietary deal idea or a relevant auction process comes up, the discussion will seem like a natural extension of ongoing dialogue rather than an out-of-the-blue outreach after an extended period of time.

Think long-term: One-off diligence calls are by definition, short-term sound bytes. While subject matter expertise may serve as the initial impetus for outreach, consider long-term value when engaging for the first time. Rather than focus on a narrow set of specific questions, expand the discussion and explore potential opportunities to engage more broadly or just to stay in touch. The most productive and rewarding PE-executive relationships exist over many years and multiple funds with the executive adding value in several ways, whether as a diligence consultant, interim/permanent CEO, board member, industry networker or deal sourcer. The savviest PE firms leverage their robust network of relationships to get ahead of auction oftentimes hearing about processes before they are formally launched. Executives want to be engaged beyond one-off calls and the right long-term relationship is an invaluable asset for both sides.

Network with purpose: More is not always better, and when it comes to executive interactions, aim for quality (productivity) over quantity (more meetings). The proliferation of intermediaries has produced a large number of networking meetings, many with no tangible objectives or expected outcomes beyond making the acquaintance. It is not uncommon for retiring corporate CEOs to meet dozens of PE firms through investment banking contacts and friends. Sometimes, after attending a series of meetings, they may forget who they met, as the differences are not obvious to them. On the flip side, PE firms schedule meetings on an opportunistic basis as well. With no clear purpose in mind and no real follow-up, sometimes these interactions become forgotten blips rather than meaningful connections.

Think two-way: Productive relationships are by nature, two-way. They must be reciprocal in order to have sustainability. Whereas a PE firm may reach out initially with an urgent need for insight, they may forget to offer anything in return, if not immediately, then over time. This does not always have to be a fee or commercial arrangement, though after multiple interactions, without some form of payment or anticipated compensation, many executives become frustrated with what appears to be a one-sided relationship. While the reaction may seem obvious, this dynamic has evolved over time from many PE firms' belief that the networking opportunity offsets the executive's efforts. With better and more prolific access today, this is no longer the case.

Senior to senior relationship: When a PE firm has a meeting with a 30+ year industry veteran, it is most appropriate to bring an equivalently experienced PE investor – ideally one with relevant sector expertise – to the table. First impressions happen only once, and sometimes PE firms get only one opportunity to make an impact. Best to lead with a senior member of the investment team who has experience and sector knowledge and can speak in greater depth and more fluency than a junior member or a generalist with little exposure to the executive's industry.

The fact that executive relationships are strategic is not new news. The competitive dynamic to attract and retain executive attention

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC

is growing at a rapid pace, and the posturing of the most sought after CEOs is a growing concern. The dynamic stop-go nature of PE deals, the inherently finite nature of PE funds and portfolios, and the economic model for PE firms provide a challenging context for sustaining long-term relationships with executives. PE firms need to define a strategic framework for managing their executive relationships. Without an intentional approach to executive networking and cultivation, PE firms and executives run the risk of getting lost in the shuffle or worse, damaging reputations or relationships on either side.

Established in 2002, Notch Partners LLC is the pre-eminent provider of leadership capital and management-led buyout strategies for private equity firms. Our mission is to maximize our clients' returns in every stage of the investment process through high impact relationships with industry-leading C-level executives.

Mei-Mei Tuan
Managing Partner
mtuan@notchpartners.com
973-921-1229

Andrew Thompson
Managing Partner
athompson@notchpartners.com
973-921-0341

www.notchpartners.com

Copyright © 2015, Notch Partners LLC
May not be reproduced in whole or in part without permission of Notch Partners LLC